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RUEATRS/DEPT OF TREASURY WASHDC
RHMFIUU/DEPT OF ENERGY WASHINGTON DC
RUEHRC/USDA FAS WASHDC
RUEKJCS/SECDEF WASHDC
RHEHNNSC/NSC WASHDC
RHHMUNA/USCINCPAC HONOLULU HI
RHHJJAA/JICPAC HONOLULU HI
RUEKJCS/JOINT STAFF WASHDC

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SIPDIS

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SENSITIVE

DEPT FOR A/S HILL AND EAP/MTS
DEPT FOR E STAFF - JEFF YOUNG
TREASURY FOR IA-RDOHNER, ABAUKOL, KBERG
SINGAPORE FOR BAKER
DEPT PASS USTR FOR DBHATIA AND DKATZ
COMMERCE FOR 4430/BERLINGUETTE
ENERGY FOR A/S HARBERT, CUTLER AND GILLESPIE

E.O. 12598: N/A

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SUBJECT: U/S JEFFERY MEETS WITH ECONOMISTS AND BUSINESS LEADERS

¶1. (SBU) Summary. U/S Jeffery discussed Indonesia's economy and investment climate with economists and business leaders September 10-11 in Jakarta. Outlying regions such as Aceh and Papua face infrastructure and development challenges. Large established western companies with good local partners can be profitable in Indonesia, but despite investment climate problems such as legal uncertainty and corruption which deters new entrants. End Summary.

Aceh, Papua and Decentralization Challenges

¶2. (SBU) During a working dinner on September 10, Under Secretary discussed reconstruction, investment climate and decentralization challenges in Indonesia. Former Economic Minister Dorodjatun Kuntjoro-Jakti noted that the tsunami losses in Aceh were unbelievable but the generosity of the donors was tremendous. A World Bank representative donor noted that there were 1,600 ethnic Chinese businesspeople active in the local Nias market before the disasters: now many are refusing to go back. Dozens of companies in Aceh relocated to Medan. Hundreds of the best and brightest students were wiped out. The Asian Development Bank country director noted that now that much of the reconstruction is completed or underway, the growing challenge is finding the people to train for hospitals and clinics. An Asia Foundation representative worried that the current donor-induced boom could bring on a donor-induced slump after 2009.

¶3. (SBU) Regarding Papua, the Ambassador noted that the local government has capacity constraints to spend both budget and donor money. The World Bank said that 3% of GDP is currently sitting in local government accounts, unspent. The October 2005 fuel price hikes absorbed disposable income from the economy, increasing the budget and thus regional transfers in 2006. This, in turn, created absorption problems for many local governments. Money is often going to local government apparatus such as vehicles and buildings rather than to social welfare programs. Corruption makes it hard to

get programs through that can withstand real scrutiny, but locally elected officials are under real political pressure to improve services. Dorodjatun said that infrastructure development is difficult because most construction companies in Indonesia are Chinese-controlled and located in East Java, unwilling to go to places like Papua. Road density in Papua is only 1 kilometer per 100 square kilometers.

Investment Climate: The Usual Suspects

¶ 4. (SBU) U/S Jeffery asked what the impediments are to an improved investment climate and one economist noted, "the usual suspects," referring to Indonesia's oft-criticized obstacles. These include a lack of legal certainty; unclear land titles leading to problems with collateral; poor roads, inefficient ports; insufficient electricity in many areas; corrupt tax and customs administration; and labor issues, especially non-competitive severance pay. While the growth rates are respectable, they have not been enough to bring down poverty and unemployment significantly. Indonesia also has natural disasters with great frequency. Dorodjatun added that Indonesia lost ten years of infrastructure development due to the financial crisis of 1997-98. However, the Ambassador added that many U.S. companies have been operating in Indonesia for a long time, and are making healthy profits, so the picture is not all bleak.

AmCham Complains, but Wants
Indonesia to Reach Its Potential

¶ 5. (SBU) In a closed meeting with business leaders from the American Chamber of Commerce, a representative of the insurance industry said that Indonesians have not yet embraced the concept of

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insurance, relying instead on the extended family. Fourteen international companies including MetLife, New York Life and AETNA left Indonesia in the past five years. An attorney who represents foreign interests stated that the legal system in Indonesia is "harrowing." He advises clients in commercial disputes that they cannot afford the corrupt court system and will lose because they cannot play the game the Indonesian way. Western company executives are sometimes jailed in the case of a dispute with a local partner. The Parliament is a big part of the problem, demanding payment for passing legislation. There are honest judges, however, and the current anti-corruption efforts are the most credible in Indonesia's history. The Anti-Corruption Commission (KPK) needs more money and staff.

¶ 6. (SBU) A representative of the oil and gas industry noted that a western company needs the right local partner to protect it. Interests have to be aligned. A mining industry representative concurred, noting that if you are big enough, established and have the right partner, you can survive the other problems. Former President Soeharto succeeded in making business deals because he took Indonesia's bureaucracy out of the equation. When Soeharto fell, hundreds of contracts of work (the partnership between the central government and the foreign investor) were cancelled. While Indonesia's natural resource potential is huge, the business climate makes it tough for any but the largest players and deters new entrants. Another issue is the lack of encouragement of entrepreneurship. While Indonesians are early adopters of western gadgets and goods (new cell phone technology, Krispy Kreme donuts), innovative businesses and original ideas get little support. AmCham members concluded that despite problems, they are making money. Indonesia can have stronger growth and they want it to reach its potential.

¶ 7. (U) After delivering well-received remarks to a joint lunch meeting of American and Indonesian Chamber of Commerce (AmCham - KADIN) business leaders, U/S Jeffery answered questions about biofuels, the Tropical Forest Conservation Act debt swap and energy cooperation. Prominent business leader and Chairman of the Indonesian Employers' Association Sofyan Wanandi, said that Asia is still concerned about ongoing ripple effects of the sub-prime

mortgage problems in the U.S. How serious are the worldwide effects and how will it impact U.S. consumer behavior? U/S Jeffery noted that the U.S. economy still has strong fundamentals, and that responsible policy makers have been injecting liquidity into the system. Asian markets and the ASEAN region are also stronger than ever, thus more able to withstand external shocks. The recent APEC statement in support of the Doha round emphasizes that free and fair trade benefit all our economies.

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